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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1957

No. 852

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BANK OF NEVADA,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit.

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PETITION FOR A WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled case on December 31, 1957.

CITATIONS TO OPINIONS BELOW.

The opinion of the District Court printed in Appendix B hereto is reported in 155 F.Supp. 164. The

opinion of the Court of Appeals printed in Appendix B hereto has not yet been reported.

JURISDICTION.

The judgment of the Court of Appeals was entered on December 31, 1957. Rehearing was denied on February 7, 1958. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED.

Whether the right of a bank, when served with a notice of levy, to set-off a depositor's account against a loan made after the tax lien arose, as set forth in *United States v. Bank of Shelby* (5th Cir. 1934), 68 Fed.2d 538, and *United States v. Bank of United States* (S.D.N.Y. 1934), 5 F.Supp. 942, has been abrogated without any substantive change in the applicable statutes.

STATUTES INVOLVED.

The statutory provisions involved are Sections 6321, 6322, 6323, 6331 and 6332 of the Internal Revenue Code of 1954. They are printed in Appendix A.

STATEMENT OF THE CASE.

J. D. Bentley of Las Vegas was a regular customer of petitioner, Bank of Nevada. He maintained an ac-

tive commercial account from time to time secured financial accommodation from the bank. In this connection he furnished periodic financial statements. The three which are important in the present case were dated August 31, 1954, February 28, 1955, and May 31, 1955 (R. 17-18, 15-16 and 20-21). All of the financial statements contained an identical agreement regarding transactions between Bentley and the bank. This agreement so far as pertinent here provides that "if any deposit account of the undersigned [Bentley] with you [the bank] be attempted to be obtained or held by writ of execution, garnishment, attachment or other legal process, * * * then in such case, at your option, all of the obligations of the undersigned to you, or held by you, shall immediately become due and payable, without demand or notice." The purpose of this argeement and its relation to the right of set-off is obvious. However, such an agreement may have been unnecessary in view of Section 8737 of Nevada Compiled Laws 1929, which reads:

> "Every garnishee shall be allowed to retain or deduct out of the property, effects, or credits of the defendant in his hands all demands against the plaintiff and all demands against the defendant of which he could have availed himself if he had not been summoned as garnishee, whether the same are at the time due or not, * * *."

The right of set-off which the bank asserted in the present case arose in connection with a loan of $2,000.00 which the bank made to Mr. Bentley on April 16, 1955 and credited to his commercial account (R. 22). The loan was evidenced by a promissory note

due on demand, or "if no demand is made, then on August 14, 1955" (R. 19), and was subject to the right of set-off upon service of legal process. When the loan was made the bank did not have actual knowledge of the federal tax lien in the amount of $804.50 which was assessed on November 15, 1954, but not recorded until January 12, 1955 (R. 14), and of course the bank could not have any knowledge of the unrecorded federal tax lien in the amount of $187.51 which had been assessed May 1, 1955, but was not recorded until June 13, 1955 (R 19).

Bentley's account was active, with many deposits and many withdrawals. The government does not question the withdrawals, even those made after the liens arose. The government's position regarding relations between a bank and its customers in the ordinary course of business is set forth in Rev. Rul. 57-367, 1957-32 Int. Rev. Bull. 22, printed in full in Appendix A. This ruling says, in substance, that in the absence of negligence or fraud, a bank, without actual notice or knowledge of the existence of a federal tax lien (as distinguished from constructive notice) will not incur liability to the government by permitting withdrawals by a depositor against whom a federal tax lien is outstanding.

On June 10, 1955, Bentley's account showed a balance of $878.16 (R. 26). On that date, at 1:45 P.M., a notice of levy was served on the bank (R. 28). Later on the same day the bank notified the District Director by letter that the balance of $878.16 had been set-off against Bentley's debt to the bank and that, there-

fore, the bank did not hold any funds subject to levy (R. 12).

On June 14, 1955, a final demand was served on the bank (R. 12-13), and on September 28, 1955, the government filed suit against the bank for the $878.16 plus interest at the rate of 6% per annum and costs under Section 6332 of the Internal Revenue Act. This is not a suit against the taxpayer, but a penalty suit against the bank "in its own person and estate."

The government contends, as we understand it, (a) that the bank had no right of set-off because the loan was made after the lien arose, even though the bank did not have actual knowledge of the recorded lien and could not have had any knowledge of the unrecorded lien, and (b) that the right of set-off, if it existed, was waived because the set-off was made "after" the levy was served.

The bank contends (a) that the loan and the right of set-off are inseparable in that both arose out of the same transaction, one being the consideration for the other; (b) that the balance in Bentley's account was not his money but the bank's money which he could use only until "a writ of execution, garnishment, attachment or other legal process" was served on the bank; and (c) that the right of set-off was exercised at the moment the levy was served, even though it took a few moments to walk to the ledger, ascertain the balance and make the entry.

The District Court held that the bank was liable and said (155 F.Supp. 167-168) "the Bank had no

right to set-off and apply the funds in Bentley's account on the promissory note."

The Court of Appeals affirmed on the grounds (a) that the right of set-off was inchoate and therefore inferior to the tax lien; (b) that in the absence of a "demand" the note was not intended to be payable until August 14, 1955, despite the agreement that it became due at the option of the bank "without demand or notice" when the levy was served; and (c) that the right of set-off was exercised "after" rather than at the time the levy was served. Both *United States v. Bank of Shelby,* supra, and *United States v. Bank of United States,* supra, were cited by petitioner as appellant below, but neither of them is mentioned in the opinion of the Court of Appeals.

REASONS FOR GRANTING THE WRIT.

1. Although the opinion below did not mention the decision of the Fifth Circuit in *United States v. Bank of Shelby,* supra, there is a direct conflict. The tax lien involved in the *Bank of Shelby* case was assessed on March 12, 1925, against one Toler. The bank loaned Toler $10,000 on June 8 and took a note due the following November. Of this amount, $6,400 was applied to past due unsecured notes which Toler owed the bank, and the difference was put to his credit on the books; in other words, deposited to his account. Apparently there was a small existing balance because the actual amount in the account at the time of the levy was $3,646.52. The deputy collector inquired at

the bank on June 17, was told the amount of the balance, and notified the bank not to allow any withdrawals. The levy was served the next day, June 18, and payment was refused. The demand and refusal were repeated in February, 1926, and in August, 1926, and the United States then sued the bank and a vice president to recover the amount of the deposit. The bank defended on the ground that at the time of the demand nothing was owed to Toler because the deposit was offset by the note.

The Fifth Circuit in upholding the right of set-off did not base its decision on the insolvency of the taxpayer. Instead the court said:

> "But there is present here another potent fact, that the two obligations arose out of the same transaction and the one is the consideration for the other. It would be manifestly inequitable to enforce one obligation when the other cannot be enforced." 68 F.2d 539.

A careful reading of the *Bank of Shelby* case indicates that it is in direct conflict with the case here presented. We realize that *United States v. Bank of United States* (S.D.N.Y. 1934) 5 F.Supp. 942, being a district court case does not present a direct conflict between the circuits; however, it, with the *Bank of Shelby* case, represented what was believed to be the law prior to the instant case.

2. The question presented by this case and the two other bank cases upon which we rely is of obvious and great importance in the day to day banking transactions throughout the nation. Although, as indicated,

United States v. Bank of United States, supra, is a district court case, it appears to be indistinguishable from the present case; it did not involve insolvency and the tax lien arose prior to the time the loan was made. Like the instant case, the taxpayer had made deposits and withdrawals from the time the loan was made until the levy was received. The district court, in upholding the right of set-off pointed out that while the taxpayer was indebted to the bank he was really operating his account under what may be called a "revocable license" with the bank and that certainly in the absence of circumstances which would amount to an estoppel this would not be a basis "for letting the garnisher come in and take something which the depositor himself did not have." (5 F.Supp. 945). The *Bank of Shelby* case was decided January 23, 1934, and the *Bank of United States* case was decided February 6, 1934. Since that time the banks throughout the country have relied upon these two cases. There has been nothing to the contrary until the present case and the government admitted in its brief below that there has been no substantive change in the applicable statutes. During this time (24 years) banks throughout the country have relied upon the right to set-off when a notice of levy is received even though the loan was made without actual knowledge of an existing tax lien. We shall not speculate on the impact of the decision below on banking practices and the availability of credit, but settlement of the question by this court is plainly in the public interest.

3. The decision below is believed to be erroneous. Not only is it in conflict with *United States v. Bank*

of Shelby, supra, but it is contrary to the established principle set forth in *North Chicago Rolling-Mill Co. v. St. Louis Ore & Steel Co.,* 152 U.S. 596, 619, which said that a garnishee "takes the shoes of the principal debtor and can assert only the rights of the latter."

There can be doubt that this principle applies to the Collector. The Fifth Circuit said in *United States v. Bank of Shelby, supra,* "the United States can claim only under and through him and subject to the defenses and equities affecting him." (68 F.2d 540). The Third Circuit said in *Karno-Smith Co. v. Maloney* (1940) 112 F.2d 690, 692, "the rights of the Collector rise no higher than those of the taxpayer whose right to property is sought to be levied upon," citing the decision of the Second Circuit in *United States v. Western Union Telegraph Co.* (1931), 50 F.2d 102.

The Ninth Circuit had previously recognized this same principle in *United States v. Winnett* (1947), 165 F.2d 149, but refused to apply it to the present case where there was no showing of insolvency and where the debt arose after the liens attached. We see no basis for the distinction. Mr. Bentley's right or "revocable license" to use the credit balance in his commercial account was at all times after the loan was made on April 16, conditioned upon and subject to the right of the bank to declare the debt due without demand or notice and to set-off when a levy or any other legal process was served; without the loan (subject to this condition) there would have been no balance in the account.

The court below also suggested that this court in *United States v. Security Trust and Savings Bank*

(1950), 340 U.S. 47, had "frowned" upon the doctrine of "relation back" and to that extent possibly weakened the effect of the *Winnett* case which depended upon an agreement made before the tax lien arose.

United States v. Security Trust and Savings Bank, supra, and the cases which have followed it deal with priorities of various liens and should not control a right of set-off which was part of the consideration for the debt. The right of set-off in our opinion is not a lien. This seems to follow from the fact that money on deposit in a bank belongs to the bank subject to the rights of the depositor, and a bank cannot have a lien on its own property. However, the government suggested in the court below that the right of set-off might be a lien, and it so would be subordinated to a prior tax lien. This overlooks one pertinent fact. The only possible lien would be a pledge dependent upon possession, and Section 6323(c) of the Internal Revenue Code makes the tax lien invalid, even though recorded, against the bank as a bona fide pledgee of a "security" which by definition includes "money."

CONCLUSION.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

March 11, 1958.

Respectfully submitted,

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(Appendices A and B Follow.)

Appendix A

Internal Revenue Code of 1954.

SEC. 6321. LIEN FOR TAXES

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 6322. PERIOD OF LIEN

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS

(a) *Invalidity of lien without notice*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws*—In the office designated by the law of the State or Territory in

which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of district court*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) *With clerk of district court for District of Columbia*—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) *Form of notice*—If the notice filed pursuant to subsection (a) (1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a)(2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

(c) *Exception in case of securities*—

(1) *Exception*—Even though notice of a lien provided in section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a security, as defined in paragraph (2) of this subsection, as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's

worth, if at the time of such mortgage, pledge or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

(2) *Definition of security*—As used in this subsection, the term "security" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

(d) *Disclosure of amount of outstanding lien*—If a notice of lien has been filed under subsection (a), the Secretary or his delegate is authorized to provide by rules or regulations the extent to which, and the conditions under which, information as to the amount of the outstanding obligation secured by the lien may be disclosed.

SEC. 6331. LEVY AND RESTRAINT

(a) *Authority of Secretary or delegate.* If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to

such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency or instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401(d)) of such officer, employee, or elected official. If the Secretary or his delegate makes a finding that the collection of such tax is in jeopardy, notice and demand for immediate payment of such tax may be made by the Secretary or his delegate and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

(b) *Seizure and sale of property*—The term "levy" as used in this title includes the power of distraint and seizure by any means. In any case in which the Secretary or his delegate may levy upon property or rights to property, he may seize and sell such property or rights to property (whether real or personal, tangible or intangible).

(c) *Successive seizures*—Whenever any property or right to property upon which levy has been made by virtue of subsection (a) is not sufficient to satisfy the claim of the United States for which levy is made, the Secretary or his delegate may, thereafter, and as often as may be necessary, proceed to levy in like manner upon any other property liable to levy of the person against whom such claim exists, until the

amount due from him, together with all expenses, is fully paid.

SEC. 6332. SURRENDER OF PROPERTY SUBJECT TO LEVY

(a) *Requirement*—Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

(b) *Penalty for violation*—Any person who fails or refuses to surrender as required by subsection (a) any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made, together with costs and interest on such sum at the rate of 6 per cent per annum from the date of such levy.

(c) *Person defined*—The term "person," as used in subsection (a) includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under duty to surrender the property or rights to property, or to discharge the obligation.

The provisions of Sections 3670, 3671, 3672, 3690 and 3710 of the Internal Revenue Code of 1939 are substantially the same as the provisions of the 1954 Code which are set forth above. The above provisions of the 1954 Code are applicable after January 1, 1955, to all internal revenue taxes whether imposed by the 1939 or 1954 Codes. Section 7851(a)(6)(B) of the Internal Revenue Code of 1954 (26 U.S.C. 1952 ed., Sup.II, Sec. 7851).

Rev. Rul. 57-367, 1957-32 Int. Rev. Bull. 22:

Advice has been requested whether banks, acting in the ordinary course of business with a depositor, without any knowledge of Federal tax liens having been filed against the depositor, and in the absence of negligence or fraud are subject to the rule of constructive notice of such liens.

G.C.M. 5432, C.B. VIII-1, 134 (1929), holds, in part that a notice of lien filed by a Collector of Internal Revenue (now District Director) with the proper official covers all property and property rights, whether real or personal, belonging to a delinquent taxpayer, and operates as a lien on bank deposits of the taxpaper and on debts due a taxpayer, even though a specific notice of the lien has not been served on the bank or on the debtors of the delinquent taxpayer.

To the extent here pertinent, G.C.M. 5432 stands for the proposition that debts due a taxpayer and bank accounts constitute property or rights to property subject to the Federal tax lien and that anyone

(including a bank) who, in relation to such property, acquires the status of a mortgagee, pledgee, purchaser, or judgment creditor after notice of lien has been filed, does so subject to all the provisions of law under which the lien is valid and effective, irrespective of whether he had actual notice of the lien. However, where a bank acting in the ordinary course of business with a depositor, does not have actual notice or knowledge of the existence of a Federal tax lien (as distinguished from constructive notice given by the filing of a notice of lien as prescribed in the Internal Revenue Code of 1954), and in the absence of negligence or fraud, the bank will not incur liability to the Government in making payments to a depositor or on the order of a depositor, against whom a Federal tax lien is outstanding, to the extent of the amount the depositor has on deposit with the bank.

Where a bank does have actual notice or knowledge of the existence of a Federal lien against a depositor, the principles under which adverse interests in or to property or rights to property are entitled to protection may be applicable. In such cases, if the person against whom the lien is outstanding fails to take appropriate action to obtain its release, or to obtain a discharge of the property from the lien, the bank may protect itself against the possibility of liability to the Government by notifying the District Director of Internal Revenue of the facts and by requesting advice as to the action to be taken to enforce the lien, meanwhile withholding payment of the sum in question.

G.C.M. 5432, C.B. VIII-1, 134 (1929) is amplified.

Appendix B

In the United States District Court
in the District of Nevada

United States of America, Plaintiff, v. Bank of Nevada, Defendant.	Civ. No. 135 Mar. 14, 1957

FOLEY, District Judge.

The case was submitted upon stipulation of facts together with attached exhibits and supplemental stipulation filed November 7, 1956. The parties are in agreement as to the questions presented for determination, viz.:

1. Whether the defendant was in possession of property of the delinquent taxpayer which was subject to the tax lien sought to be levied against said bank deposits of the taxpayer, and

2. Whether a Federal tax lien on the bank account of a delinquent taxpayer is superior to the claimed right of setoff in the Bank by virtue of the taxpayer's note to the Bank executive after the tax lien arose, or by virtue of an agreement between the Bank and the taxpayer contained in a financial statement executed with the Bank before the tax lien arose.

However, the Bank's contentions are largely based upon its assumption that the taxpayer's note was payable at any time without demand.

In United States v. Graham, D.C., 96 F.Supp. 318, 320, affirmed State of California v. United States, 9 Cir., 195 F.2d 530, Judge Harrison held:

"[4-6] The contention that there is no property against which the plaintiff's tax liens may be foreclosed is without support. 'Congress intended to subject all of a taxpayer's property, except that specifically exempt to the payment of taxes. "Property" is a word of very broad meaning and when used without qualification, may reasonably be construed to include obligations, rights and other intangibles, as well as physical things. "Property" within the tax laws should not be given a narrow or technical meaning.' Citizens State Bank of Barstow, Texas v. Vidal, 10 Cir., 114 F.2d 380, 382.

* * *

"[7] There yet remains the question of whether or not the state may set off against its debt to the taxpayer the taxes owed by the taxpayer to the state. It is unquestioned that under Secs. 3672 and 3710(a), Title 26 U.S.C.A., the rights of the Collector do not extend beyond those of the taxpayer whose right to property is sought to be levied upon. United States v. Winnett, 9 Cir., 1947, 165 F.2d 149. If the state had a right of set-off against the taxpayer prior to the United States' asserted lien and priority, the Collector would be bound to recognize the right of the state to set-off.

"[8] The 1942 income tax assessment against the taxpayer, Warren C. Graham, was received by the Collector on March 23, 1945, more than a year and three months before the leases with the State

of California were entered into. The tax due under this assessment is still due. Any money that accrued to the taxpayer under the lease with the state accrued with a lien impressed upon it. There was no period of time in which the state of California's right of set-off could have been asserted against the debt to the taxpayer that the property was not impressed with the tax lien. In United States v. Winnett, supra, the right of set-off accrued before any tax liens arose."

The sum of $878.16 on deposit with defendant Bank in the account of the taxpayer was, at the time of the service of Notice of Levy by the District Director of Internal Revenue, property of Bentley, the taxpayer.

The financial statements, Exhibits "B" and "B-1", executed prior to the loan evidenced by the note of April 16, 1955, each contained the following:

"The undersigned, for the purpose of procuring and establishing credit from time to time with you and to induce you to permit the undersigned to become indebted to you on notes, endorsements, guarantees, overdrafts or otherwise, furnishes the following as being a true and correct statement of the financial condition of the undersigned on the above date, and agrees to notify you immediately of the extent and character of any material change in said financial condition, and also agrees that if the undersigned, or any endorser or guarantor of any of the obligations of the undersigned, at any time fails in business or becomes insolvent or commits an act of bankruptcy, or if any deposit account of the undersigned with you, or any other property of the undersigned held by

you, be attempted to be obtained or held by writ of execution, garnishment, attachment or other legal process, or if any of the representations made below prove to be untrue, or if the undersigned fails to notify you of any material change as above agreed, then and in such case, at your option, all of the obligations of the undersigned to you, or held by you, shall immediately become due and payable, without demand or notice. This statement shall be construed by you to be a continuing statement of the condition of the undersigned, and a new and original statement of all assets and liabilities upon each and every transaction in and by which the undersigned hereafter becomes indebted to you, until the undersigned advises in writing to the contrary."

Upon the above quoted paragraph of the financial statements and the note of April 16, 1955, the Bank bases its claimed right of setoff. The note provided that:

"On Demand; if no demand is made then on August 14th, 1955, for value received I promise to pay in lawful money of the United States of America, to the order of the Bank of Nevada * * * Two Thousand and no/100 Dollars. * * *"

"Although the maker of a demand note is not in default until he refuses payment until after demand therefor, it is generally held that a note payable on demand is due immediately, so that suit may be maintained on it at any time after delivery without any other demand than the suit. This rule may not apply, however, where there is something on the paper or in the circumstances under which it was given to show that it was not

the intention that it should become due immediately." 10 C.J.S. Bills and Notes § 274b, p. 744; Sullivan v. Ellis, 8 Cir., 219 F. 694, 696, citing 7 Cyc. 848, 849.

[1] From the above quoted portion of the note it appears that it was not the intention of the payee or the maker of the note that the same was to be due immediately upon delivery. It was the evident intention of the parties that the note was to become due August 14, 1955, unless in the meantime a formal demand by the Bank for payment was made.

Defendant Bank, in its brief, states:

"* * * the bank had a right of set off and thereby a lien upon any funds of the taxpayer on deposit with it, which arose prior in time to the date of November 15, 1954, which was the date upon which the tax lien arose. This lien of the bank was created by virtue of the financial statement dated August 31, 1954, (Exhibit B-1), wherein the bank was given the right by the depositor to apply any and all funds against any and all indebtedness of the taxpayer-depositor without demand and without notice to the taxpayer-depositor when and as certain conditions existed or came into being which jeopardized the claim of the bank under its promissory demand note, and which materially changed the taxpayer's-depositor's financial condition."

On June 10, 1955, the taxpayer had on deposit with defendant Bank in a checking account the sum of $878.16. On November 15, 1954, Withholding and Federal Insurance Contribution Act taxes for the calen-

dar year 1954 in the amount of $804.50 were assessed against the taxpayer. On March 1, 1955, Federal Excise taxes for the calendar year 1954 in the amount of $187.51 were assessed against the taxpayer.

On June 10, 1955, the District Director of Internal Revenue caused to be served upon the Bank a Notice of Levy covering both of the assessments. As has been noted, at the time of the service of the levy, no part of the obligation secured by the note was due and no contention is made that at that time the taxpayer was insolvent.

Therefore, the principles stated in the following quotation can have no application here:

> "The propriety of allowing the offset is at once apparent, and, in view of the fact that the lessor had become insolvent, it is immaterial that under the terms of the lease the return of the deposit was not yet due. In City Investment Company v. Pringle, 73 Cal.App. 782, 239 P. 302, the court reviewed the authorities relating to set-offs against insolvent debtors, and there said at page 791 of 73 Cal.App., 239 P. 302, 306, '* * * insolvency itself is a sufficient ground for the application of equitable set-off, and the fact, that the indebtedness on one side is not due when set-off is claimed, constitutes no obstacle to the assertion of the right as against an insolvent debtor.' " Gordon v. Foote, 120 Cal. App. 76, 7 P.2d 709, 710.

On the same day, June 10, 1955, after service of the levy, the Bank attempted to exercise its claimed right of setoff of the balance remaining unpaid on the note

against the $878.16 on deposit to the credit of the taxpayer. From Exhibit "E" it appears that for the period beginning April 1, 1955, to September 6, 1955, the Bank accepted taxpayer's deposits and honored his withdrawals. The exhibit indicates substantial withdrawals by depositor for several months after the claimed right of setoff.

[2, 3] The Federal tax liens upon all property and rights to property belonging to the taxpayer arose prior to the loan of April 16, 1955, and prior to any right of setoff on the part of the Bank, if such right existed.

The Court's attention has been called to § 8737, Nev. Comp.Laws 1929, which is as follows:

> "Every garnishee shall be allowed to retain or deduct out of the property, effects, or credits of the defendant in his hands all demands against the plaintiff and all demands against the defendant of which he could have availed himself if he had not been summoned as garnishee, whether the same are at the time due or not, * * *."

That this state law cannot give superiority to the Bank's claimed right of setoff over the pre-existing liens is made apparent by Mr. Chief Justice Stone in State of Michigan v. United States, 317 U.S. 338, 340, 63 S.Ct. 302, 87 L.Ed. 312, where he stated:

> "We do not stop to inquire whether this construction of the state statutes is the correct one, for we think the argument ignores the effect of a lien for federal taxes under the supremacy clause of the Constitution. The establishment of a tax lien by Congress is an exercise of its constitu-

tional power 'to lay and collect taxes.' Article I, § 8 of the Constitutional power 'to lay and collect U.S. 210, 13 S.Ct. 846, 37 L.Ed. 705. And laws of Congress enacted pursuant to the Constitution are by Article VI of the Constitution declared to be 'the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.'

" 'It is of the very nature and essence of a lien, that no matter into whose hands the property goes, it passes cum onere.' * * * Hence it is not debatable that a tax lien imposed by a law of Congress, as we have held the present lien is imposed, cannot, without the consent of Congress, be displaced by later liens imposed by authority of any state law or judicial decision. United States v. Snyder, supra; United States v. City of Greenville, 4 Cir., 118 F.2d 963."

Even if any rights the Bank might have had under the Nevada statute had the dignity of a lien, no right under that statute could displace the prior tax liens existing here.

On June 10, 1955, and prior thereto, the amount on deposit to the credit of Bentley was burdened with the prior existing Federal tax liens. On that date Bentley was solvent and the note of April 16, 1955, had not matured and would not become payable prior to August 14, 1955, in the absence of a demand. In the face of these facts, the Bank had no right to set off and apply the funds in Bentley's account on the promissory note.

Upon the stipulation of the parties, the Court finds:

Findings of Fact.

1. This is a civil action for the collection of taxes; jurisdiction over this suit is granted by §§ 1340 and/or 1345 of Title 28 U.S.C.A. This suit has been authorized by the Commissioner of Internal Revenue of the United States and has been brought under the direction of the Attorney General of the United States.

2. The defendant is a corporation organized and existing under the laws of the State of Nevada with its principal place of business in Las Vegas, Clark County, Nevada.

3. On November 15, 1954, certain Withholding and Federal Insurance Contributions Act taxes for the calendar year 1954 in the amount of $804.50 were assessed against J. D. Bentley of Las Vegas, Nevada, hereinafter referred to as the taxpayer. Thereafter, and on November 16, 1954, taxpayer was notified of this assessment and demand was made upon him to pay it, but he has refused to do so.

4. On January 12, 1955, a notice of tax lien pertaining to this assessment of Withholding and Federal Insurance Contributions Act taxes was filed in the Office of the County Recorder, Clark County, Nevada, Exhibit "A."

5. On February 28, 1955, and on August 31, 1954, the taxpayer submitted to the Bank of Nevada financial statements, Exhibit "B" and "B-1" respectively.

6. On March 1, 1955, certain Federal Excise taxes for the calendar year 1954 in the amount of $187.51 were assessed against the taxpayer, and on that same

date the taxpayer was notified of this assessment and demand was made upon him to pay it, but he has refused to do so.

7. On April 16, 1955, J. D. Bentley, and his wife, Doris L. Bentley, borrowed $2,000 from the Bank of Nevada and executed a promissory note in favor of the Bank for that amount, Exhibit "C".

8. On May 31, 1955, the taxpayer submitted to the Bank of Nevada another financial statement, Exhibit "D".

9. On June 10, 1955, the taxpayer had on deposit in an account with the Bank of Nevada the sum of not less than $878.16, Exhibit "E". On that day, June 10, 1955, the District Director of Internal Revenue, through H. L. Collomb, Collection Officer, served a Notice of Levy, Form 668-A, upon the Bank of Nevada by delivering it to E. K. Phillips, Assistant Cashier, at 1:45 p. m. This Notice of Levy covered both of the assessments, referred to in Findings Nos. 3 and 6, together with statutory additions thereto, Exhibit "F".

10. On that same day, A. M. Smith, Vice-President and Manager of the First and Fremont Branch of the Bank of Nevada wrote to H. L. Collomb, Collection Officer, as follows:

> "This will acknowledge receipt of your Notice of Levy against J.D. Bentley, which was served on our Mr. Phillips at 1:45 P.M. today.
>
> "I would like to take this opportunity to inform you that we have exercised our right to set off and applied the funds in this account to an unsecured indebtedness held at this bank; consequently, there are no funds available under your levy."

The "unsecured indebtedness" referred to in this letter was the balance of the note referred to above in Finding No. 7, which, at the time of the levy, amounted to approximately $1,500.

11. The Bank of Nevada did, on the 10th day of June, 1955, subsequent to 1:45 p. m. of said day, exercise its "claimed" right of setoff and applied the funds in this account to the taxpayer's unsecured indebtedness.

12. On June 13, 1955, a notice of Federal tax lien pertaining to the assessment of Federal Excise taxes was filed in the Office of the County Recorder, Clark County, Nevada, Exhibit "G".

13. On June 14, 1955, the District Director of Internal Revenue, through H. L. Collomb, Collection Officer, served a Final Demand, Form 668-C, upon the Bank of Nevada by delivering it to A. M. Smith, Vice-President and Manager of the First and Fremont Branch of the Bank of Nevada, at 11:10 a. m., Exhibit "H".

Conclusions of Law.

The Court concludes:

1. That plaintiff's tax liens are paramount and valid liens and that plaintiff is entitled to judgment in the amount of $878.16 plus legal interest and costs as provided by § 6332, Internal Revenue Code 1954, 26 U.S.C.A. §6332.

The plaintiff, United States of America, shall submit a form of judgment to the Court for approval.

United States Court of Appeals
For the Ninth Circuit

Bank of Nevada, Appellant, vs. United States of America, Appellee.	No. 15,541 Dec. 31, 1957

Appeal from the United States District Court for the District of Nevada

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Before STEPHENS, Chief Judge, LEMMON and HAMLEY, Circuit Judges

LEMMON, Circuit Judge.

While the Internal Revenue Code of 1954 "contains a variety of important changes in the estate and gift tax areas",[1] it has left untouched the well established principle that the amount of an unpaid tax "shall be a lien in favor of the United States upon all property and rights to property"[2] of the delinquent taxpayer.

No government worthy of the name will permit itself to be rendered incapable of collecting the public fisc.

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[1]"Revision of the Federal Estate and Gift Taxes: The Internal Revenue Act of 1954", by Marvin Chirelstein and Benjamin M. Shieber, *Stanford Law Review, December*, 1954, Volume 7, Number 1, page 40.

[2]Internal Revenue Code of 1954, §6321, *infra*.

At any rate, in this respect at least, the United States Government has not been left impotent.

1. *Statement of Facts*

The facts as found by the Court below were entirely stipulated. They may be summarized as follows—with especial regard to the chronology, since time-sequence is important here:

On November 15, 1954, certain Witholding and Federal Insurance Contributions Act taxes for the calendar year 1954 in the amount of $804.50 were assessed against J. D. Bentley of Las Vegas, Nevada, hereinafter referred to as the taxpayer. On the following day the taxpayer was notified of this assessment and demand was made upon him to pay it, but he has refused to do so.

On January 12, 1955, a notice of tax lien pertaining to this assessment was filed with the County Recorder of Clark County, Nevada.

On February 28, 1955, and on August 31, 1954, the taxpayer submitted financial statements to the appellant. Each statement read in part as follows:

> "The undersigned, for the purpose of procuring and establishing credit from time to time with you and to induce you to permit the undersigned to become indebted to you on notes, endorsements, guarantees, overdrafts or otherwise, furnishes the following as being a true and correct statement of the financial condition of the undersigned on the above date, and agrees to notify you immediately of the extent and character of any material change in said financial condition, and also agrees

that if the undersigned, or any endorser or guarantor of any of the obligations of the undersigned, at any time fails in business or becomes insolvent, or commits an act of bankruptcy, or if any deposit account of the undersigned with you, or any other property of the undersigned held by you, be attempted to be obtained or held by writ of execution, garnishment, attachment or other legal process, or if any of the representations made below prove to be untrue, or if the undersigned fails to notify you of any material change as above agreed, then and in such case, *at your option,* all of the obligations of the undersigned to you, or held by you, shall immediately become due and payable, without demand or notice. This statement shall be construed by you to be a continuing statement of the condition of the undersigned, and a new and original statement of all assets and liabilities upon each and every transaction in and by which the undersigned hereafter becomes indebted to you, until the undersigned advises in writing to the contrary." [Emphasis supplied.]

On March 1, 1955, certain Federal excise taxes for the calendar year 1954 amounting to $187.51 were assessed against the taxpayer, and on that same date the taxpayer was notified of this assessment. Demand was made upon him to pay it, but he has refused to do so.

On April 16, 1955, the taxpayer and his wife, Doris L. Bentley, borrowed $2,000 from the appellant and executed a promissory note in favor of the appellant for that amount.

On May 31, 1955, the taxpayer submitted to the appellant another financial statement, containing the

same provision relating to the appellant's right of set-off that has been quoted *supra*.

On June 10, 1955, the taxpayer had on deposit in an account with the appellant "the sum of not less than $878.16". At 1:45 p.m. on that day, the appellee, through one of its collection officers, served a "Notice of Levy" upon the appellant by delivering it to E. K. Phillips, the assistant cashier. This Notice of Levy covered both of the assessments referred to above.

On that same day, A. M. Smith, vice president and manager of the appellant's First and Fremont Branch, wrote to the appellee's collection officer as follows:

> "This will acknowledge receipt of your Notice of Levy against J. D. Bentley, which was served on our Mr. Phillips at 1:45 p.m. today.
>
> "I would like to take this opportunity to inform you that we have exercised our right to setoff and applied the funds in this account to an unsecured indebtedness held at this bank; consequently, there are no funds available under your levy."

The "unsecured indebtedness" referred to in the above letter was the balance of the note for $2,000, referred to above, which balance, at the time of the levy, amounted to approximately $1,500. The appellant exercised its "claimed" right of setoff *subsequently* to 1:45 p.m. on June 10, 1955, the precise time at which the appellee's collection officer delivered the Notice of Levy to the appellant's assistant cashier. The appellant concedes that it exercised its right of setoff "thereafter."

On June 13, 1955, a notice of Federal tax lien pertaining to the assessment of Federal excise taxes was filed in the office of the County Recorder of Clark County, Nevada.

On June 14, 1955, the appellee's collection officer served a final demand upon the appellant's vice president and manager of its First and Fremont Branch.

On September 28, 1955, the appellee filed suit in the Court below to recover from the appellant the sum of $878.16, with interest and costs. As we have seen, that sum represented the amount which the taxpayer had on deposit with the appellant on June 10, 1955.

The case was submitted upon a stipulation of facts, together with attached exhibits.

The District Court held that the appellee's "tax liens are paramount and valid liens," and that the appellee was entitled to judgment as prayed for.

On March 29, 1957, the District Court handed down a judgment accordingly.

On April 5, 1957, the Notice of Appeal was filed.

2. *The Appellant's Contentions*

The appellant's argument may be summarized as follows:

The trial court erred in "ignoring the established principle that the bank has a general lien or right of setoff against the deposits of the despositor for the indebtedness of the depositor to the bank."

The Court erred in finding that the promissory note was not a demand note and due immediately upon delivery.

There was no property of the depositor-taxpayer in the possession of the appellant subject to the tax lien.

The right of set-off in the appellant was paramount to the appellee's tax lien.

3. *The Applicable Statute*

The pertinent sections of the Internal Revenue Code of 1954 are the following:

> "*§6321. Lien for taxes*
>
> "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.
>
> "*§6322. Period of Lien*
>
> "Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

"*§6323. Validity against mortgagees, pledgees, purchasers, and judgment creditors*

"(a) *Invalidity of lien without notice.*—

Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary [of the Treasury] or his delegate— * * *

"*§6331. Levy and distraint*

"(a) *Authority of Secretary or delegate.*— If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. * * *

"*§6332. Surrender of property subject to levy*

"(a) *Requirement.*—Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process."

4. *Liens for Federal Taxes and the Provisions for Their Collection Are Strictly Federal and Strictly Statutory*

At the ouset, what appears to be a basic misconception of the appellant should be cleared up. In its main brief, the appellant cites a number of state decisions to the effect, *inter alia,* that a party in the appellant's position "has a general lien or right of set off against the deposits of the depositor for the indebtedness of the depositor to the bank"; and that there is a right to set off enjoyed by a bank "by virtue of a specific agreement with its depositor", and that only the sum left, "after deducting the debits from the credits, in favor of the depositor was the balance or property *subject to the tax lien.*" [Emphasis supplied]

The Supreme Court has repeatedly and emphatically stated that Federal tax liens and the provisions for their collection are strictly *Federal* and strictly *statutory.* Those provisions are unaffected by any alleged "general rule" that a bank has a "general lien" upon deposits.

In United States v. Security Trust & Savings Bank, Executor, 1950, 340 U.S. 47, 49-50, the Court said:

> "The effect of a lien in relation to a provision of federal law for the collection of debts owing the United States is *always* a Federal question. Hence, although a state court's classification of a lien as specific and perfected is entitled to weight, it is subject to reexamination by this Court." [Emphasis supplied.]

Again, in United States v. Acri, 1955, 348 U.S. 211, 213, the Supreme Court used the following language:

> "The relative priority of the lien of the United States for unpaid taxes is, as we said in *United States v. Waddill Co.*, 323 U.S. 353, 356, 357; *Illinois v. Campbell*, 329 U.S. 362, 371; *United States v. Security Trust Co.*, 340 U.S. 47, 49, always a federal question to be determined finally by the federal courts. The state's characterization of its liens, while good for all state purposes, does not necessarily bind this Court. [Cases cited.]"

This Court likewise has adhered to the Federal norm in evaluating a Federal tax lien. In MacKenzie v. United States, 9 Cir., 1940, 109 F.2d 540, 541, Judge Stephens said:

> "The federal tax lien is entirely statutory, therefore its scope and effect are to be determined solely by the statute and the decisions interpreting it."[3]

5. ***The Appellant Could Not Shield the Taxpayer's Account By an Inchoate Agreement with Its Depositor or by a Claimed Equitable Right of Setoff Springing From a Debt Not In Existence When the Tax Liens Arose.***

Section 6332(a), *supra*, gives the appellant only two defenses; namely, (1) that it was not in possession of property of the taxpayer which was subject to levy; or (2) that the property was subject to a

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[3]See also United States v Scovil, 1955, 348 U.S. 218, 220.

prior judicial attachment or execution. The statute admits of no other defenses.[4]

In the instant case, of course, judicial attachment or execution does not figure. The appellant does maintain, however, that it did not have in its possession "property rights [sic] to property subject to levy" at the time of demand or levy by the District Director of Internal Revenue on June 10, 1955.

This is based upon the further contention that the appellant had a "right of set off" bottomed upon the agreement of August 31, 1954, and "the demand note" of April 16, 1955, *supra*. It is argued that by virtue of the agreement of August 31, 1954, which "prior to the assessment of taxes against the taxpayer on November 15, 1954 [*supra*], or the recording of the notice of tax lien on January 12, 1955 [*supra*]," the appellant has acquired "a right of set off by contract which was paramount to the subsequent tax lien." Finally, it is urged that "there existed no balance in the depositor-taxpayer's account which was subject to levy by the District Director of Internal Revenue".

We do not agree. The appellant could not protect itself from a Federal tax levy by the taxpayer's inchoate agreement, or by an asserted right of setoff arising from a debt that was not in existence at the time the tax liens arose, *supra*. The liens came into

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[4]See United States v Manufacturers Trust Co., 2 Cir., 1952, 198 F.2d 366, 369; United States v Third Nat. Bank & Trust Co., DC Pa., 1953, 111 F.Supp. 152, 156.

being at the time the assessments were made. See §6322, *supra.*

In United States v Graham, DC Cal., 1951, 96 F. Supp. 318, 321, affirmed *per curiam sub nom.* State of California v United States, 9 Cir., 1952, 195 F.2d 530, certiorari denied, 1952, 344 U.S. 831, the District Judge said:

"The 1942 income tax assessment against the taxpayer, Warren C. Graham, was received by the Collector on March 23, 1945, more than a year and three months *before* the leases with the State of California were entered into. The tax due under this assessment is still due. Any money that accrued to the taxpayer under the lease with the state *accrued with a lien impressed upon it. There was no period of time in which the State of California's right of set-off could have been asserted against the debt to the taxpayer that the property was not impressed with the tax lien.* In U.S. v Winnett, supra, the right of set-off accrued *before* any tax liens arose. . . .

* * *

"Assuming arguendo that the State of California may assert an equitable set-off against a delinquent taxpayer, the set-off could have been asserted *no earlier than the time at which the lease agreements were entered into with the taxpayer. No set-off could arise until such time as there existed something to be set-off against.* But the rights of the taxpayer under the lease were born with the *tax lien impressed thereon.*

"Assuming further that the set-off and the tax liens attached simultaneously to the interest of the taxpayer created by the lease agreements, no

> citation of authority is needed to establish that *the federal tax lien is superior to any simultaneously attaching interest of the State of California.* Therefore the rights of the State of California, with respect to the money accrued as rentals under the leases made with the taxpayer are inferior to the tax liens of the United States." [Emphasis supplied.]

It should be noted here that this Court affirmed the District Court's judgment in the *Graham* case, *supra,* "On the ground and for the reasons stated" in the District Judge's opinion. We adhere to the teaching of *Graham.*

"The first in time is the first in right" was declared to be the determining principle by Mr. Justice Minton, in United States v. New Britain, 1954, 347 U.S. 81, 85-86.

In that case, the Court quoted the following language of Mr. Chief Justice Marshall in Rankin & Schatzell v. Scott, 25 U.S. 177, 179:

> "The principle is believed to be universal, that a prior lien gives a prior claim, which is entitled to prior satisfaction, out of the subject it binds, unless the lien be intrinsically defective or be displaced by some act of the party holding it, which shall postpone him in a court of law or equity to a subsequent claimant."

In its opinion in the *New Britain* case, *supra,* the Supreme Court continued:

> "This principle is widely accepted and applied, in the absence of legislation to the contrary. 33

Am. Jur., Liens, §33; 53 C.J.S., Liens, §10b. We think that Congress had this cardinal rule in mind when it enacted §3670 [the predecessor of §6321, *supra*], a schedule of priority not being set forth therein. Thus, the priority of each statutory lien contested here must depend on the time it attached to the property in question and became *CHOATE.*" [Emphasis supplied.]

An examination of the lengthy paragraph quoted *supra* from the financial statements of August 31, 1954, February 28, 1955, and May 31, 1955 will convince even the casual reader of the record that whatever lien the appellant had upon the taxpayer's deposit on those dates was *INCHOATE* in the extreme!

The doctrine of "relation back" cannot avail the appellant here. In the *Security Trust* case, *supra,* 340 U.S. at pages 50-51, the Court used language quite apposite here:

> "Nor can the doctrine of relation back--which by process of judicial reasoning merges the attachment lien in the judgment and relates the judgment lien back to the date of attachment--operate to destroy the realities of the situation. When the tax liens of the United States were recorded, Morrison did not have a judgment lien. He had a mere "*caveat* of a more perfect lien to come. . . .
>
> * * *
>
> ". . . Accordingly, we hold that the tax liens of the United States are superior to the *INCHOATE* attachment lien of Morrison, . . ." [Emphasis supplied.]

Finally, the Court in United States v. Kings County Iron Works, 2 Cir., 1955, 224 F.2d 232, 237, tersely summarized the rule that is applicable here:

> "The mere attachment of the government's [tax] lien gives it a fully perfected claim superior to all except mortgagees, pledgees, purchasers, or judgment creditors of the taxpayer."

No amount of legalistic sophistry can erode the Gibraltar of that rule.

6. *The Appellant's Inchoate Right of Setoff Cannot Override the Appellee's Choate Tax Levy*

The appellant insists that there is a "general" rule that "a bank has a general lien upon or right of set off against all monies or funds in its possession belonging to a depositor to secure the payment of a depositor's indebtedness to it". It specifies as error the District Court's "finding that the federal tax liens upon all property and rights to property belonging to the taxpayer arose prior to the loan of April 16, 1955, and prior to any right of set off on the part of the [appellant]".

The record does not show that the taxpayer was indebted to the appellant at the time the agreement of August 31, 1954 was executed. The record does show, however, that the debt which the appellant is attempting to set off did not arise until April 16, 1955, *after* the tax liens of November 15, 1954, and March 1, 1955 came into existence. These two latter dates are the assessment dates, and, as we have seen, under §6322 "Unless another date is specifically fixed by

aw, the lien imposed by section 6321 shall arise at the ime the assessment is made".

We have also seen that the identical agreements of August 31, 1954, February 28, 1955, and May 31, 1955, specified the following contingencies that would give rise to the appellant's right to exercise its option of set off.

(a) If the taxpayer failed in business or became nsolvent;

(b) If the taxpayer's deposit account or any other property of the taxpayer held by the appellant was the subject of an attempt to be obtained or held by writ of execution, garnishment, attachment or other legal process;

(c) If the taxpayer failed to notify the appellant of any material change in the taxpayer's financial condition; and

(d) If any of the taxpayer's representations proved to be untrue.

It is clear that the only fact which gave the appellant the option to set off was the appellee's demand and levy; but that demand and that levy admittedly took place *prior* to the alleged exercise of the appellant's option.

Under the present facts and under the authorities already referred to, the appellant cannot avail itself of finespun "general" theories dealing with a bank's "general" lien or "right" of setoff. The Federal tax collector is not to be frustrated in this way.

7. *In the Absence of a Demand, the Taxpayer's Note Was Not Intended To Be Payable Until August 14, 1955*

So far we have assumed that the taxpayer's note was a true demand note, due and payable on the date of its face, April 16, 1955. The due date specified in the instrument itself, however, read as follows:

> "On Demand; if no demand is made then on August 14th, 1955. . . ."

No demand was made by the appellant; but, as we have seen, on June 10, 1955, the appellant's officer announced, *after* the notice of levy was received by the bank, that the bank had exercised its right of setoff, etc.

In the absence of demand, a note of the type that we are here considering falls due on the alternative date specified.

In Sullivan v Ellis, 8 Cir., 1915, 219 F. 694, 696, the Court said:

> "The general rule with regard to commercial paper, payable on demand, is that it becomes due immediately, and that the statute of limitations begins to run from its date.
>
> " 'This rule may not apply where there is something on the paper, or in the circumstances under which it is given, showing that it was not the intention that it should become due immediately.' 7 Cyc. 848, 849."

In 10 C.J.S. §247b, page 744, we find the rule correctly stated:

"* * *

"Although the maker of a demand note is not in default until he refuses payment until after demand therefor, it is generally held that a note payable on demand is due immediately, so that suit may be maintained on it at any time after delivery without any other demand than the suit. *This rule may not apply, however, when there is something on the paper,* or in the circumstances under which it was given, to show that it was not the intention that it should become due immediately, . . ." [Emphasis supplied]

In the instant case, there assuredly was "something on the paper . . . to show that it was not the intention that it should become due immediately", in the absence of a demand. No demand was made.

But even if we assume, for the sake of the argument, that the commercial paper was a true demand note and therefore became due on the date of its execution and delivery—April 16, 1955—even at *that* early date, the appellee's tax liens had already attached. We have seen that on January 12, 1955, a notice of tax lien pertaining to the November 15, 1954, assessment of withholding and insurance contributions taxes was filed with the County Recorder; and on March 1, 1955, certain excise taxes for 1954 were assessed against the taxpayer, who, after notice and demand, had refused to make payment.

Accordingly, according to whatever theory we consider the appellant's rights under the taxpayer's note of April 16, 1955, those rights are *junior* to the appellee's tax liens.

Furthermore, regardless of dates, the mere fact that the note might be due does not mean that an equitable right of setoff necessarily exists.

In American Surety Co. v City of Akron, 6 Cir., 1938, 95 F.2d 966, 970, the Court noted the subordinate position of setoff:

> "However, this right of equitable set-off is not absolute or paramount to the superior equities of other claimants. [Case cited.] Cf. Gray v School District, 3 Cir., 67 F.2d 141, 143, which pointed out that the right of equitable set-off could be enforced only where no equity of third persons will be injured."

In the instant case, we are not even faced with the problem of balancing equities. We are asked to balance an inapplicable equitable principle against the plain mandate of a tax statute. "Equity follows the law."

The appellant relies heavily upon our decision in United States v Winnett, 9 Cir., 1947, 165 F.2d 149. That case, however, is readily distinguishable on the facts. There, *before* the tax liens attached, Winnett endorsed the taxpayer's notes, with the understanding, both oral and written, that in the event the taxpayer defaulted in any or all of the payments, and Winnett was called upon to make good, the amount so paid by Winnett could be set off against any

amounts due or to become due on a note previously executed by Winnett in favor of the taxpayer Summers.

Furthermore, also *before* the tax liens attached, the taxpayer became insolvent. Here, of course, no insolvency is involved.

That the taxpayer's *insolvency* was the primary, though not the sole, basis for this Court's holding that the tax lien "was enforceable against Winnett only as to the unpaid balance of the $60,000 note after deducting the amount of the claimed off-sets", is evident from the following language of the *Winnett* opinion:

> "Because of the insolvency of Summers [the taxpayer] on January 1, 1939, the equitable right of set-off accrued to Winnett on that date, under the laws of the state of California notwithstanding his claim was then based upon a contingent obligation; furthermore, his equitable right to set-off related back to the date of agreement for set-off, which was prior to the lien of the United States."

The appellant also relies upon *Winnett* for the proposition "that the rights of the [appellee] do not extend beyond those of the taxpayer whose right to property is sought to be levied upon". If we assume this proposition to be correct, it should be pointed out that on the dates of levy and demand or, of recordation—November 16, 1954, January 12, 1955, and March 1, 1955, and June 10, 1955,—the taxpayer had full right to use his bank account, and, indeed, did continue to use it thereafter.

It will be observed that in the above excerpt from Winnett, our Court stated that Winnett's "equitable right to set-off related back to the date of agreement for set-off, which was prior to the lien of the United States". The Supreme Court of the United States, however, in the *Security Trust* case, supra, which was decided nearly three years after *Winnett,* frowned, as we have seen, upon the doctrine of "relation back"—at least when that doctrine was invoked to frustrate the sovereign in the collection of its fisc.

Finally, in the *Winnett* case, this Court observed that Winnett "should not be required to pay the same debt twice even though the interposition here is by the sovereign". In the instant case, at least, the appellant is in no danger. As Chief Judge Parker well observed in United States v Eiland, 4 Cir., 1955, 223 F.2d 118, 121-122:

> ". . . payment to the government pursuant to the levy and notice is a complete defense to the debtor against any action brought against him on account of the debt. [Cases cited.]"

8. *Conclusion*

No strained theories of setoff, relation back, or the like can frustrate the sovereign from collecting its taxes in this case. The stubborn principle remains, under the facts of this case, that the appellant is liable for failing to surrender, after levy and demand, the bank account to which the liens had attached.

Accordingly, the judgment is

Affirmed.

(Endorsed:) Opinion. Filed Dec. 31, 1957.
Paul P. O'Brien, Clerk.

United States Court of Appeals
for the Ninth Circuit

Bank of Nevada, Appellant, vs. United States of America, Appellee.	No. 15,541

JUDGMENT

Appeal from the United States District Court for the District of Nevada.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the District of Nevada, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the Judgment of the said District Court in this cause be, and hereby is affirmed.

(Endorsed) Judgment

Filed and Entered: December 31, 1957

Paul P. O'Brien, Clerk